No. 15963

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

CLAIRE B. MORSE,

Appellant,

vs.

UNITED STATES OF AMERICA,

Appellee.

APPELLANT'S REPLY BRIEF.

GEORGE T. ALTMAN,
233 South Beverly Drive,
Beverly Hills, California,
Attorney for Appellant.

Parker & Son, Inc., Law Printers, Los Angeles. Phone MA. 6-9171.

TABLE OF AUTHORITIES CITED

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The government concedes (Br. 13) that it has the burden of proving transferee liability. Yet there are several elements of such liability which the government has clearly failed to establish.

1. The government must prove the value of the property transferred. This the government concedes (Br. 13).

(a) Assuming the government's theory (Br. 11) that there was distributed to appellant a 10 per cent interest in the partnership, that would be 10 per cent of the excess of the value of the assets over the liabilities at the time of the transfer. The record shows clearly that *after* the transfer additional federal taxes for years prior to those involved here were determined and paid [R. 13, par. 13, as corrected at R. 80]. Yet these additional liabilities were obviously not reflected by the "agreed" value shown in the purported partnership agreement.

(b) Also on the question of value of the alleged partnership interest, appellee repeats again and again a serious distortion of fact. As one instance of this (Br. 18), appellee says: ". . . it certainly was not unreasonable for the District Court to accept the parties' determination of the value of the partnership interest." The impression is there given that the term "parties" refers to the parties to this proceeding. This is heightened by appellee's selection of cases in support of that point. Not one of the cases cited supports a value for the purposes involved here based upon a figure recited in a partnership agreement, but one of them, *Stokes v. Commissioner,* 22 T. C. 415, does contain a determination by the parties to the *tax proceeding.* It is clear, of course, that appellant here had no connection whatever with the recitation of value in the purported partnership agreement. It was not in any sense a determination by the parties to this proceeding.

2. In reference to the so-called transferee agreements, appellee quotes from the findings that the government "accepted the agreements and relied thereon." As we have shown in our opening brief, at page 53, not only did the government not rely on those agreements; it in fact violated those agreements. There is, moreover, an additional factor which must be noted. Reliance itself is insufficient. As to those "transferee agreements," and also any other documents signed by appellant, it must be shown that the government relied thereon to its *detriment.* (*Girard v. Gill* (C. A. 4), 59-1 U. S. T. C. par. 9144, decided Dec. 15, 1958. There was no such showing here.

3. Appellee contends that even though the purported partnership agreement was introduced only to prove the forgery the trial court could rely on it generally because it was incorporated as Exhibit A in the complaint, Exhibit

T herein, by reference. As its reason appellee states (Br. 14) that "Without the partnership agreement, the complaint for dissolution and an accounting was incomplete." However, it was also incomplete for other reasons. The purported partnership agreement was attached as Exhibit A and a copy of a letter purporting to terminate appellant's interest in the partnership was attached as Exhibit B [R. 99]. That Exhibit B, nevertheless, the government failed to produce [R. 99], and, contrary to appellee's statement (Br. 14-15), appellant did object to the introduction of Exhibit T [R. 128]. The objection made by appellant was to every part of Exhibit T other than the signature pages, because there was no indication that any of the other pages were the same as those that were before her when she signed.

If appellee now reasons that Exhibit A to that complaint was necessary to make it complete, then so was Exhibit B. By appellee's own reasoning Exhibit T herein was objectionable and should not have been admitted.

4. Among the elements for which appellee relies wholly upon the purported partnership agreement is the one that the partnership "was formed for the express purpose of taking over the assets of the corporation and continuing the operation of the business" (Br. 14, ftn.).

The parties expressly stipulated, however, that at the time of the liquidation of the corporation the partnership was in existence and was the sole shareholder [R. 12]. The actual transfer of corporate assets was to the partnership [R. 12]. The shareholders at no time received any interest in them. This is what happened and what actually happened governs. As stated in *Helvering v. Tex-Penn Oil Co.,* 300 U. S. 481, 493, 57 S. Ct. 569, 574, "The validity of the ultimate finding . . . is to be tested by

what in fact was done rather than by the mere form of words used in the writings employed." To the same effect, *Hatch Estate v. Commissioner* (C. A. 9), 198 F. 2d 26. If there was in fact a partnership at all the partnership was the transferee and not the individuals.[1]

5. Appellee attempts an argument that under Illinois law "a person may ratify an instrument even though the affixing of his signature initially was a forgery" (Br. 15). As clearly stated, however, in 10 C. J. S. 1077, citing numerous cases, including *Hefner v. Dawson,* 63 Ill. 403, 14 Am. Rep. 123, "the rule in such cases rests, however, on the doctrine of estoppel rather than that of ratification." To support the result in such cases it must be shown that the principal either received a benefit or induced the other party to change his position to his prejudice. The very cases cited by appellee support this.

Thus, it is stated in *Fay v. Slaughter,* 194 Ill. 157, 169-170, 62 N. E. 592, 596-597:

> "In the absence of express ratification, leaving aside the equitable view of it, he could not be deemed, in law, by implication, to have ratified the acts of Anderson [agent] unless with a knowledge of its source, and the material facts relating to the manner in which it came into his bank account were brought home to him, and then, with that knowledge, *appropriated the money, or part of it, to his use.* . . . In this record there is no evidence showing, or tending to show, that plaintiff in error got the *real benefit*

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[1]Appellee contends in the same footnote (Br. 14) that appellant herself bases her argument in part on the contents of the partnership agreement. But this is strictly an alternative argument as shown by the clear terms of appellant's opening brief. The title there, page 37, begins with the word "Even." See, also, page 38, "The *so-called* partnership agreement," and "taking the document itself at face value." (Italics added.)

of any of this money, either by checking it out for his own use or by its being checked and applied to his business." (Italics added.)

In *Livings v. Wiler,* 32 Ill. 387, it is likewise stated, at page 399:

> "But *plaintiff has received and appropriated the proceeds of this mortgage to her own use,* just as much as if she had received the proceeds in gold, and placed it in her pocket; and that too, after she knew all about it, and even after she had denied and protested that it was not her mortgage, but was a forgery. After she knew all this, and when she knew that the proceeds of the mortgage stood to her credit in her account against [her bankers] she sued them upon that account, *and obtained judgment against them* for this account, thus including the proceeds of this mortgage." (Italics added.)

In *Hefner v. Vandolah,* 57 Ill. 520, it was stated, at page 521:

> "It is conceded that the signature to the note in controversy is not the genuine signature of the appellant. The evidence abundantly establishes that it is a forgery. The single question presented, is whether the appellant, by his declarations and conduct, is *estopped* from denying the execution of the note." (Italics added.)

In *Hefner v. Dawson, supra,* referring to the case of *Hefner v. Vandolah, supra,* the court likewise based its conclusions on the elements of estoppel.

And in *Chicago Edison Co. v. Fay,* 164 Ill. 323, 45 N. E. 534, 536, it was stated:

> "But the finding was, and we think properly so under the evidence, that there was not sufficient evi-

dence to show that Fay *knowingly took or retained any of Slaughter & Co.'s money* derived from the transfers of stock, and it was necessary to show knowledge on the part of Fay before an implied ratification could be established on the grounds attempted."

The case of *Vetesnik v. Magull,* 347 Ill. 611, 617, 180 N. E. 390, cited by appellee (Br. 15-16) involved no forgery and still the court there relied on the elements of estoppel. There the principal received the benefits. The same is true in *Magid v. Drexel Nat. Bank,* 330 Ill. App. 486, 71 N. E. 2d 898, and *Commercial Loan & Trust Co. v. Mallers,* 141 Ill. App. 460, affirmed, 237 Ill. 119, 86 N. E. 728, cited by appellee. In the latter case there was a benefit to the principal and in the former there was a detriment to the other party.

As the court here found, while appellant sued she never received anything [R. 55]. And estoppel cannot be based on a claim on which no recovery is had. *Shinsaku Nagano v. McGrath* (C. A. 7), 187 F. 2d 753, 758. Indeed here there was not even any proof that the suit was ever prosecuted. When the trial court asked whether the suit was ever prosecuted, government counsel answered, "I don't know, your Honor" [R. 101].

Not only does ratification under Illinois law require the elements of estoppel. As shown in appellant's opening brief, at page 47, that is exactly what the court below meant by ratification. That court meant estoppel. But the elements of estoppel were not established. This appellee's brief does not deny.

6. As the cases above cited also show, a ratification can only be made with full knowledge of all the facts. As more

clearly stated in *Scharf v. Solomon,* 297 Ill. App. 155, 17 N. E. 2d 240, 242:

> "A party alleging, asserting, or relying on a ratification of the unauthorized act of an agent has the burden of proving it. To sustain the burden of proof, the party on whom it rests must show that the ratification was made under such circumstances as to be binding on the principal; he must show that the principal intended to ratify and, at the time of ratification, had full knowledge of all the material facts connected with the transaction. 3 C. J. S., Agency, Sec. 319(2).
>
> "In the case of the *Farmers National Bank v. Trautwein,* 228 Ill. App. 356, it is said: 'It is a well-settled rule that knowledge of the terms and conditions of an unauthorized contract entered into by an agent is not to be presumed from the fact that the principal had a reasonable opportunity to acquire such knowledge. . . . "A principal's ratification of an agent's unauthorized act must be clearly shown, either directly or impliedly, from clear and unequivocal circumstances." In order to bind a principal by ratification, assent or acquiescence in prior acts of his agent in excess of authority actually given, a knowledge of the material facts must be brought home to him. He must have been in possession of all of the facts and must have acted in light of such knowledge. 21 R.C.L. 928; Coleman v. Connolly, 242 Ill. 574-583, 93 N.E. 278, 134 Am. St. Rep. 347; Cadwell v. Meek, 17 Ill. 220-227.' "

But here the trial court itself said, as noted in appellant's opening brief, page 47, "I feel sorry for Mrs. Borin because I don't think she knew what was going on."

Furthermore, appellee's attempt in that connection to show that no doubtful state of facts exists (Br. 16-17)

contains specific misstatements. For example, there is the statement that the "taxpayer filed her individual income tax return for the year 1944 reporting only one item of income which was her distributable share of the partnership income." This is wholly false. As the court below found [R. 54], she signed that return in blank. She didn't know at all what it was about.

Again, the record showing [R. 85] that there was no delivery of any stock certificate to appellant, appellee contends, in a footnote (Br. 17), that this does not invalidate her ownership of the stock, that her ownership is adequately shown by the partnership agreement. Thus as to ownership of the stock appellee relies, not upon independent evidence, but again upon the theory of ratification, which as shown above is wholly inapplicable here.

Furthermore, much more recent authority shows that under Illinois law delivery *is* necessary for a transfer of stock. *Shinsaku Nagano v. McGrath, supra,* at p. 756, 23 A. L. R. 2d 1189-1190.

Besides, as shown in appellant's opening brief, page 21, citing *Jacob, et al. v. Commissioner* (C. A. 9), 139 F. 2d 277, delivery may be important for tax purposes. In that case as here, there was no delivery, and there, as here, no actual assets were received by the alleged recipient of a stock ownership. There likewise transferee liability was involved and it was held that no such liability arose. Here, what Nathan Borin did, including the forgery of the partnership agreement, was precisely the same solitaire as occurred in the *Jacob* case.

7. Appellee attempts (Br. 18) to twist the trial court's language "burden of proving" into meaning "going forward" with the evidence. As shown in appellant's opening

brief, page 13, moreover, this language was drafted by appellee and not by the court. What the trial court did was to accept appellee's assumption at the trial that the burden of proof was upon appellant. That this was error, appellee now concedes.

8. In regard to the payment of the taxes involved, appellee apparently admits that there is no proof that the taxes assessed against the transferor were not paid. At Br. 7, it says that "No part of the unpaid balances has been paid," citing R. 53, which shows that the reference is to the assessments against appellant as transferee. At Br. 19, appellee repeats this statement. Appellee also states there that there was no payment by the corporation, the alleged transferor. But it does not say anywhere that the taxes of the transferor were not paid. Indeed, appellee stated before the trial court [R. 101-102] that this was for the taxpayer to prove. It is clear, as shown in appellant's opening brief, pages 55-56, that this is an essential element of the government's case which the government has failed to establish.

9. Appellee attempts to cite the decision of this court in *Maletis v. United States*, 200 F. 2d 97, which involved the controlling individual in a fictitious family partnership, for the proposition that any other person whose name he uses in the fictitious structure is bound by what he does. This court in that case held no such thing. Nor did the Supreme Court in the case there cited, *Higgins v. Smith*, 300 U. S. 473. The very contrary is true, as shown by this court's decision in *Jacob v. Commissioner, supra*, cited in appellant's opening brief, page 21. Appellee attempts (Br. 22) to distinguish that case but what happened there is exactly what happened here. As in that case another person, Nathan Borin, and not the appellant, was trying

to use a fictitious partnership for his own purposes. Appellant here was only one of the victims, as in the *Jacob* case.

Besides, as was just recently held by this court in *Robinson v. Elliot,* 59-1 U. S. T. C. par. 9129, decided Dec. 5, 1958, the taxpayer too may recast a transaction to show its substance for tax purposes. Also, as pointed out above citing *Helvering v. Tex-Penn Oil Company, supra,* what in fact was done is what governs. If Nathan Borin were before this court now, the *Maletis* and *Higgins* cases would be pertinent. But we have here not the malefactor but one of his victims. And as the court below held again and again [R. 105-106, 132], the equities are in her favor.

Indeed, the *Maletis* case supports appellant here. This court there stated, "Maletis gained a tax benefit by not including his share of the taxable gains of the partnership in 1946." Thus this court there applied the doctrine of estoppel. As applied here, it clearly supports appellant. That doctrine lends no support to appellee here.[2]

10. Appellee says (Br. 24-25), "Taxpayer affirmed her interest in the partnership and was entitled to receive benefits from the partnership." But the partnership agreement by its own terms was the same kind of Indian gift as was involved in the *Jacob* case, *supra.* Not only did Nathan Borin in fact treat the partnership agreement as a scrap of paper. By its own terms it was little more than that. For not only did appellant receive nothing out of the

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[2]Appellee, in a footnote (Br. 23), attempts to say that the validity of the alleged partnership involved here is to be determined solely by federal law, so that no doubt was cast on it by the decree in the Illinois divorce proceeding. But the issue here is one of transferee liability which appellee concedes is determined by the law of Illinois.

purported partnership, and not only did Nathan Borin use up its funds for his own personal purposes so that there could be nothing left for her to receive. It is difficult from the agreement itself to spell out that she was entitled to receive anything.

11. Appellee (Br. 25) attempts to tie the formation of the alleged partnership and the liquidation of the corporation into a single transaction, so as to show the "net effect" of the transaction. Appellee should tie into it also then appellee's own admission in the court below that the purported transfer of stock into appellant's name prior to the formation of the alleged partnership and without her knowledge was "part of the scheme for dissolution of the corporation and creating the partnership" [R. 136]. Appellee should also tie into it the forgery of appellant's signature on the documents involved in that "scheme," and the consumption of the assets of the purported partnership by Nathan Borin for his personal uses. If "net effect" is to be given, then the entire involvement of appellant in the transaction is completely washed out.

Appellee, indeed, points up this issue in its distinction of *Vendig v. Commissioner* (C. A. 2), 229 F. 2d 93, from *Bates Motor Transport Lines, Inc. v. Commissioner* (C. A. 7), 200 F. 2d 20 (Br. 25). In a footnote there appellee shows that the distinction between the *Vendig* case and *Bates* case is that in the *Bates* case the transferee involved was in full control of the two entities involved, whereas in the *Vendig* case the transferee involved had no control at all. That is exactly the distinction here from the *Bates* case, and shows that the *Vendig* case is clearly applicable. As shown above, in connection with the *Maletis* and *Higgins* cases, we have here not the malefactor but one of his victims.

12. Appellee attempts by use of a separate point to avoid the issue of limited liability (Br. 26) but fails to give effect to what actually happened, as shown in the *Vendig* case. In the case here, as there, it was another business entity and not the individuals to which the assets were removed. If appellant received any interest in the so-called partnership she did not receive it from the corporate transferor.

13. On the issue of the exhaustion of transferee liability by prior payments, appellee contends that the payments on the prior years, that is 1940 and 1941, were not made on appellant's behalf (Br. 26). But the stipulation in the court below is clearly to that effect. It says [R. 13] that certain amounts were assessed against appellant and that the "*said* amounts" were subsequently paid in full by persons other than plaintiff (appellant here). (Italics added.)

Conclusion.

In conclusion appellant submits again that the judgment entered below was erroneous and that appellant is not liable as a transferee of Borin Art Products Corporation.

Respectfully submitted,

George T. Altman,

Attorney for Appellant.